

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 05-0294  
Gross Income Tax  
For the Tax Years 2000-2002**

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**ISSUES**

**I. Gross Income Tax—Small Business Exemption**

**Authority:** Ind. Code § 6-2.1-3-24.5; I.R.C. § 1361; I.R.C. § 1362.

Taxpayer protests imposition of gross income tax with respect to Taxpayer's parent and subsidiaries.

**II. Gross Income Tax—Advertising Fees**

**Authority:** Ind. Code § 6-2,1-1-10; Ind. Code § 6-2.1-2-2; *U-Haul Co. of Ind., Inc. v. Ind. Dep't of State Revenue*, 784 N.E.2d 1078, 1082-1084 (Ind. Tax Ct. 2002).

Taxpayer protests the imposition of gross income tax with respect to funds used to purchase advertising on behalf of its franchisees

**STATEMENT OF FACTS**

Taxpayer consists of a group of corporations engaged in the businesses of commercial cleaning and cleaning equipment sales. Taxpayer is comprised of a parent corporation ("Parent") and four wholly-owned subsidiaries ("Subsidiaries"). During the years in question, Taxpayer filed consolidated gross income and adjusted gross income tax returns. Taxpayer claimed an exemption from gross income tax based on the statutory exemption for small business companies. However, upon Department audit, it was discovered that one of Parent's shareholders was a family limited partnership. As a result, the audit determined that Taxpayer was not eligible for the small business exemption, and assessed gross income tax.

In addition, one of the subsidiaries ("Franchise Subsidiary") received monies that were to be used for advertising expenditures on behalf of the franchisors. The Department included those monies as gross income. Taxpayer protested these assessments, and a telephone hearing was held. Additional facts will be supplied as necessary.

**I. Gross Income Tax—Small Business Exemption**

### **DISCUSSION**

Taxpayer's first contention is with respect to the disallowance of the small business corporation exemption for gross income tax purposes. Under Ind. Code § 6-2.1-3-24.5(b), a corporation which qualifies as a small business corporation is exempt from Gross Income Tax. For Gross Income Tax purposes, a small business corporation is defined as having the same definition that term has in I.R.C. § 1361(b). *See* Ind. Code § 6-2.1-3-24.5(a).

During the audit, the Department indicated that Parent had a multiple-owner partnership that owned a small percentage of Parent's shares. This disqualified Parent from being a small business corporation within the meaning of I.R.C. § 1361(b)(1)(B), which limits shareholders of small business companies to certain entities, of which a multiple-owner partnership was not one of the permissible classes of owners.

Taxpayer argues that the termination of small business status with respect to Parent was inadvertent. I.R.C. § 1362(f)(1)(B) allows small business corporations that inadvertently terminate small business corporation to take remedial steps to permit continued small business corporation status. Indiana does not have a parallel remedial actions provision. Even if remedial actions were appropriate, Taxpayer has not provided sufficient information to conclude that the assessment was improper. While the federal statute provided for remedial actions, the disqualified shareholder has not undertaken remedial actions to permit the Department to reconsider the assessment with respect to Parent.

Regardless of whether Parent was a small business corporation, Subsidiaries were not small business corporations due to the fact that the Subsidiaries had a corporate shareholder, which renders Subsidiaries ineligible for such status under I.R.C. § 1361(b)(1)(B). This section limits the range of permissible shareholders to various persons or entities, but does not permit ownership by another for-profit C corporation. Accordingly, Subsidiaries did not qualify as small business corporations.

### **FINDING**

Taxpayer's protest is denied.

## **II. Gross Income Tax—Advertising Fees**

### **DISCUSSION**

Taxpayer argues that monies received by Franchise Subsidiary from its franchisees for advertising expenses on behalf of the franchisees were not subject to gross income tax. Franchise Subsidiary's arrangement was that a set amount of income from the franchisees was determined to be used for advertising on behalf of the franchisees. The franchisees paid the money to Franchise Subsidiary, which in turn used the funds for advertising expenses incurred on behalf of the franchisees. Prior to being expended, the funds used for advertising were maintained by Franchise Subsidiary in a segregated account. Franchise Subsidiary had some degree of control over the advertising expenses; however, the amounts paid were required to be

used for advertising expenses. Franchise Subsidiary earned interest on the amounts deposited for advertising and retained the interest earned.

Under Ind. Code § 6-2.1-2-2(a)(1), the receipt of “the entire taxable gross income of a taxpayer who is not a resident or a domiciliary of Indiana” was subject to gross income tax. “Receipts” means the gross income of a taxpayer, including cash or notes, for the taxpayer’s benefit. Ind. Code § 6-2.1-1-10.

The legal question is whether the subsidiary was an agent for the franchisees, and thus the funds for franchise expense were not for Franchise Subsidiary’s benefit. Taxpayer indicated that Franchise Subsidiary had some control over the revenues that it received. The ability to exercise control over the agent is the critical element for agency. *See generally U-Haul Co. of Ind., Inc. v. Ind. Dep’t of State Revenue*, 784 N.E.2d 1078, 1082-1084 (Ind. Tax Ct. 2002). Franchise Subsidiary had some degree of control over the advertising funds. Franchise Subsidiary’s control—actual or potential—over the advertising funds was sufficient to permit taxation of the advertising funds received by Franchise Subsidiary.

### **FINDING**

Taxpayer’s protest is denied.